

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
W. C. SMITH, INC. }

Appearances:

For Appellant: F. Henry NeCasek, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel;
 Jack Rubin, Assistant Counsel

O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of W. C. Smith, Inc. to a proposed assessment of additional franchise tax for the income year 1949 in the amount of \$1,387.72. Only that portion of the deficiency attributable to the disallowance by the Franchise Tax Board of a deduction in the amount of \$14,000 is in dispute. The narrow issue for decision is the propriety of the claimed deduction,

Appellant, a Minnesota corporation, is engaged in the construction business in California and other States. It computes and reports its income on the accrual basis. In 1946 its president and Mr. J. A. Campbell, the superintendent of its California operations, reached a verbal understanding for the payment to the latter of 30 per cent of the profit realized by Appellant on its construction jobs in this State. This understanding was neither discussed with nor approved by the board of directors of the corporation until 1949. In that year Appellant paid the sum in question to Mr. Campbell as a bonus for services performed by him in the year 1948.

The amount of the bonus was neither ascertained nor accrued in the books of the corporation until March 1949. Appellant's secretary states that the bonus "was not determined and did not become a liability of the corporation until the year 1949" when it "was finally agreed upon and paid". The position of the Franchise Tax Board, however, is that the bonus was not deductible in 1949 because it accrued in 1948, but that a deduction or offset for that year is now barred by the statute of limitations.

For the year 1949, Section 8(a) of the Bank and Corporation Franchise Tax Act (now Section 24343 of the Revenue and

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Taxation Code) allowed a deduction for "All the ordinary and necessary expenses paid or incurred during the income year in carrying on business, including a reasonable allowance for salaries or other compensation for personal services actually rendered..." This section was substantially the same as provisions of the Federal income tax law (now Section 162 of the Internal Revenue Code).

A deduction for **compensation** accrues when the liability becomes fixed, regardless of the year when the services were rendered. Lucas v. Ox Fibre Brush Co., 281 U.S. 115. In the case of **corporations**, the liability for bonuses or additional compensation usually becomes fixed and the amounts thereof are accruable in the year in which authorized by the board of directors. Imperial Type Metal Co. v. Commissioner, 106 Fed. 2d 302; Commercial Electrical Supply Co., 8 B.T.A. 986; Vant Construction Company T.C. Memo., Dec. Docket No. 20189, entered October 27 1950; Federal Machine & Welder Co., 11 T.C. 952. While emphasizing that the bonus paid to Mr. Campbell in 1949 was attributable to services performed by him in 1948, the Franchise Tax Board does not expressly contradict the contention of Appellant that the liability did not become fixed until 1949. We are of the opinion that Appellant did not incur a fixed obligation to pay an ascertainable amount until 1949, when a final agreement was reached and it was approved by the board of directors.

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Section 25667 of the Revenue and Taxation Code that the action of the Franchise Tax Board on the protest of W. C. Smith, Inc., to a proposed assessment of additional franchise tax in the amount of \$1,387.72 for the income year 1949, be and the same is hereby modified as follows: the action of the Franchise Tax Board in disallowing the deduction of \$14,000 paid to Mr. J. A. Campbell as additional compensation is reversed; in all other respects the action of the Franchise Tax Board is sustained.

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Done at Sacramento, California, this 18th day of
September, 1957, by the State Board of Equalization.

Robert E. McDavid, Chairman

Paul R. Leake, Member

J. H. Quinn, Member

Geo. R. Reilly, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary